Newport Legacy Zurich Switzerland: Unravelling of emerging markets and the potential impacts on New Zealand

Newport Legacy wealth management Zurich Switzerland Agree to this article.

The underlying economic troubles in emerging markets surfaced recently with Turkey, Argentina and India making headlines as their markets tumbled.

Meanwhile, trade tensions between China and the United States have brought an even more cautious tone across international markets.

While the New Zealand stock market has been able to navigate most of these headwinds to date, concerns are growing over the contagion risk emerging markets pose to our economy.

China and emerging markets were, to a large degree, the saviours of the global economy during the depths of the financial crisis in 2008, as their ability to take on debt and stimulate demand helped to support the global recovery.

New Zealand's connections with China also allowed us to largely sidestep the economic pain felt across the United States and Europe – as the nation became a more important regional trading partner, and credit creation from China and other emerging markets supported domestic property markets.

Now, looking to the future, it may not be trade tariffs that stand to be China's biggest challenge – but this massive expansion of credit, and the extreme level of both personal and corporate debt it has created.

In an attempt to manage this problem, China's government has continuously stepped in to stimulate growth, but there are tell-tale signs this has become unsustainable – as it now takes more than USD$4 of debt to generate just USD$1 of economic growth.

Overcapacity is a major issue and poses a significant deflationary risk to the rest of the world as China looks to export their economic imbalances. It's this threat which has prompted the subsequent push-back from the United States in the form of increased tariffs.

Turning to the emerging markets, many see the growth in US currency and interest rates as the cause of their troubles. In reality, these markets had been showing signs of economic stress for some time before the USD started to strengthen – and the increasing value of the USD is not the cause but a consequence of weakening local emerging market economies and domestic currency imbalances.

Excessive government spending, the likes of which we're seeing in Venezuela and Brazil, has led to dislocations and loss of investor confidence, followed by a flight of capital that has putting additional pressure on those currencies.

This in turn increases the cost of servicing debts denominated in foreign currencies, predominantly USD – increasing the demand for USD, and helping to drive its value even higher. This cycle feeds on itself and increases the domestic economic risks.

Ultimately, this has caused the breakdown of synchronised global economic growth, with emerging markets being unable to maintain the pace of growth set during the initial years of the current, decade-long global economic recovery.

This could be further amplified by the divergent monetary policies we're seeing from the central banks of developed and emerging markets – which could further tighten financial conditions in emerging markets, benefiting the US dollar and seeing emerging market economies stagnate.

Domestically, we have seen the NZD devalue by over 15 per cent this year, from its January highs – and despite a cheaper currency, exports have not experienced a major lift, with our trade deficit widening in September.

Australia has experienced a similar depreciation, with the AUD down 15.8 per cent over the same period.

With the combination of this slowing global demand for Kiwi exports, coupled with a weaker NZD and stronger oil prices, this could mean challenging times ahead in the form of greater pressure on businesses and consumers.

While concerns over emerging markets are valid, the good news is that the New Zealand economy is unlikely to fall off a cliff anytime soon – but rather we may experience a period of stagnation as our major trading partners work through their overcapacity and saturated debt levels.